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Nos. 85-558, 85-559 and 85-560

In the Supreme Court of the United States

OCTOBER TERM, 1985

ROBERT E. O'CONNOR AND GLADYS E. O'CONNOR, PETITIONERS

v.

UNITED STATES OF AMERICA

PAUL H. COPLIN AND PATRICIA COPLIN, PETITIONERS

v.

UNITED STATES OF AMERICA

JACK R. MATTOX AND MARIA MATTOX, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTION PRESENTED

Whether the court below correctly determined that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10031, did not exempt the petitioners from United States taxation on the salaries that they received from the Panama Canal Commission.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-8a) is reported at 761 F.2d 688. The opinion of the United States Claims Court (Pet. App. 9a-69a) is reported at 6 Cl. Ct. 115.

JURISDICTION

The judgments of the court of appeals were entered on May 10, 1985, and petitions for rehearing were denied on July 3, 1985 (Pet. App. 70a-71a). The petitions for a writ of certiorari were filed on September 30, 1985, and were granted on January 13, 1986. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

TREATY AND EXECUTIVE AGREEMENT INVOLVED

Article III, paragraph 9, of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10030, and Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, T.I.A.S. No. 10031, are set forth at U.S. App. 1a-2a.[1]

STATEMENT

1. On September 7, 1977, the United States and the Republic of Panama signed the Panama Canal Treaty, which was approved by the Senate and entered into force on October 1, 1979. That Treaty restored to Panama territorial sovereignty over the

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[1] "U.S. App." refers to the appendix to the government's brief filed in this Court on December 3, 1985, in response to the petitions. "O'Connor Br." refers to the petitioners' brief in No. 85-558. "Coplin Br." refers to the petitioners' brief in No. 85-559. "Mattox Br." refers to the petitioners' brief in No. 85-560.

Canal Zone, while granting to the United States the right to manage, operate and maintain the canal until the year 2000 under the auspices of the Panama Canal Commission (Commission), an agency of the United States government (Pet. App. 3a).[2] Among the many questions addressed during the treaty negotiation was whether United States citizens employed by the Commission would be subject to Panamanian income taxes on their wages. The parties to the Treaty resolved that question by agreeing that such earnings would not be taxed by Panama. That determination is reflected in Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty, also signed on September 7, 1977, which provides in pertinent part as follows:

TAXATION

> 1. By virtue of this Agreement, the Commission, its contractors and subcontractors, are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.
>
> 2. United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.
>
> 3. United States citizen employees and dependents shall be exempt from taxes, fees or

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[2] The Commission is defined as a United States government agency in Article III(3) of the Treaty and in Article I(1) of the Agreement in Implementation of Article III. See also Panama Canal Act of 1979, Pub. L. No. 96-70, § 1101, 93 Stat. 456 (22 U.S.C. 3611).

other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Commission.

2. Petitioners Robert O'Connor, Paul Coplin and Jack Mattox are United States citizens who were employed by the Commission during the relevant tax years.[3] The wages they received from the Commission were included in computing their federal income tax for years 1979 (Coplin), 1980 (Mattox) and 1981 (O'Connor and Mattox). Thereafter, petitioners filed claims for refund for the amount of tax paid with respect to income received from the Commission, urging that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty exempted that income from domestic taxation. The Internal Revenue Service denied each of their claims, and each petitioner filed a suit for refund in the Claims Court (Pet. App. 2a).

The Claims Court rejected the government's argument that Article XV of the Implementation Agreement was not intended to restrict the right of the United States to tax its citizens. The Claims Court determined that, even though the Executive Branch had consistently interpreted the Agreement as implicating only Panamanian taxes, a broad, literal interpretation of the Implementation Agreement was required because the government presented "no evidence whatsoever as to the interpretation given this lan-

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[3] Gladys E. O'Connor, Patricia Coplin and Maria R. Mattox are parties to these suits because each filed a joint tax return with her husband. Unless otherwise stated, we will refer to Robert O'Connor, Paul Coplin and Jack Mattox as petitioners.

guage by Panama" (Pet. App. 1a-2a, 29a, 61a-66a, 68a-69a (emphasis omitted)). The court stated (*id.* at 38a) that "[w]ithout a statement from Panama it is of course difficult to be certain as to what its motivations might have been." Although acknowledging that the United States' position was "conceivable" and had "common sense appeal" (*id.* at 40a), the court concluded that several other "possibilities" as to Panama's motivations "come to mind" (*id.* at 38a-39a). And, based on its own "surmise and conjecture" (*id.* at 29a), the court rejected the Executive Branch's reading of the Agreement.

3. The Federal Circuit unanimously reversed. Shortly before oral argument in the court of appeals, the Foreign Minister of the Republic of Panama delivered to the United States government a diplomatic note confirming that the Foreign Ministry of Panama agreed with the United States that Article XV of the Implementation Agreement was not intended to affect United States taxation of Commission employees (U.S. App. 4a-9a; Pet. App. 5a). The note stated (U.S. App. 4a) that Article XV(2) was:

> discussed, negotiated, and drafted exclusively with respect to the tax exemptions that the Republic of Panama would grant to United States-citizen employees of the Panama Canal Commission and their dependents * * *. The aforementioned provision[] resulted from negotiations which did not deal with the United States authority to tax the individuals mentioned therein.

Petitioners moved to strike the official statement of the Panamanian government. In denying that motion, the court stated that its role in treaty matters was limited "'to giving effect to the intent of the Treaty parties'" (Pet. App. 6a, quoting *Sumitomo*

Shoji America, Inc. v. *Avagliano*, 457 U.S. 176, 185 (1982)). Since the treaty partners agreed that Article XV of the Implementation Agreement did not exempt the salaries paid to the Commission's United States citizen employees from United States taxation, the trial court's contrary determination was reversed (Pet. App. 6a-7a). In a concurring opinion, three members of the five-judge panel concluded (Pet. App. 8a) that "[a] complete reading of the record [before the Claims Court], the treaty and the Implementation Agreement" indicates that Article XV has no bearing on the power of the United States to tax its own citizens and that it is not necessary to consider the note from the Panamanian government to reach that result since the note "merely confirms the most reasonable interpretation of the Article."

SUMMARY OF ARGUMENT

The world-wide income of United States citizens is subject to taxation by the United States, regardless of the person's residence or the source of such income. Exemption from taxation is a matter of legislative grace and may never be founded upon implication. Rather, such exemption must be granted expressly and explicitly. Petitioners here claim that Article XV of the Agreement in Implementation of Article III of the Panama Canal Treaty constitutes such an express exemption, permitting them to avoid all taxation on the salaries received from the Commission. As the Federal Circuit properly recognized, the Agreement grants no such exemption.

This Court has long recognized that the judicial role in interpreting an international agreement, whether a treaty or an executive agreement (as is the Implementation Agreement), is limited to giving

effect to the intent of the treaty partners. In determining that intent, this Court has not limited its examination to the language employed, but has relied upon the history of negotiations and the proceedings before the Senate. Nor has this Court confined its search to documents presented to lower courts; it has examined records and expressions of intent of a foreign government that were presented to it for the first time. In addition, this Court has repeatedly held that the interpretation placed on an agreement by the Executive Branch, "the Nation's organ for foreign affairs" (*Chicago & Southern Air Lines, Inc.* v. *Waterman Steamship Corp.*, 333 U.S. 103, 111 (1948)), is entitled to great weight. For that reason, deference to the Executive's view is the rule when the treaty partner is silent and even when it takes a view different from that taken by the United States. When, however, the parties to an international agreement agree as to the meaning of a treaty provision, this Court has held it inappropriate for any court to chart a different course.

The language of Article XV, the history surrounding its negotiations, and the proceedings leading to Senate ratification, all indicate that Article XV was not intended to restrict the right of the United States to tax its citizens working for the Commission, but rather was directed solely at defining the Panamanian tax status of the Commission, its agents and employees. Paragraph 2 (first sentence) of Article XV provides that "United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission." If there is any doubt that, in context, this refers only to Panamanian tax, that doubt is resolved by the paragraph's following

sentence, which exempts United States citizens employed by the Commission "from payment of taxes * * * on income derived from sources outside * * * of Panama." To read paragraph 2 as implicating any taxes other than Panamanian taxes, as the petitioners do, would give credence to the argument that even interest earned on United States bank accounts and dividends paid by domestic corporations are exempt from United States as well as Panamanian income tax, while similar income earned in Panama would be subject to both Panamanian and United States taxation.

Petitioners' reading of the treaty not only leads to absurd results, but ignores the fact that exemption from United States taxation for the Commission's United States citizen employees was never the subject of negotiations. The record reflects that there were four drafts of Article XV prepared by the United States negotiators between June 26, 1977, and August 24, 1977. The initial draft and all subsequent drafts, including the one adopted, are virtually identical. The record further indicates that the United States and Panamanian negotiators engaged in discussions over Panamanian taxation of the Commission's United States employees. But no mention was made of an exemption from United States taxation, as the note from the Panamanian government confirms.

Consistently with the history of the negotiations, the State Department advised the Senate that paragraph 2 of Article XV related exclusively to exemption from Panamanian income taxes, and not to United States income taxes. The Senate obviously was satisfied with the State Department's view, for it requested no action. The Senate committee report ac-

companying the Treaty specified that the State Department's comments were to be considered "an authoritative source of information with respect to the negotiating background and interpretation of the Treaties."

There is no factual basis for petitioners' speculation as to what might have transpired in the negotiations. Nor is there anything in the post-ratification history of the administration of the Treaty and Implementing Agreement to lend credence to petitioners' argument. The United States has always interpreted the agreement to provide for exemption from Panamanian taxation only. Even without regard to the Panamanian government's interpretation, such an Executive Branch interpretation of an international agreement is entitled to great deference.

In any event, the Government of Panama has now provided the United States with its official interpretation of the relevant provision. That interpretation is completely in accord with the interpretation advanced by the United States and adopted by the court below. Under the well-established teachings of this Court, the court of appeals properly considered the interpretation of the Panamanian government and correctly adhered to the mutual interpretation of the two parties to the Agreement.

ARGUMENT

THE INCOME PETITIONERS EARNED FROM THE PANAMA CANAL COMMISSION WAS NOT EXEMPT FROM UNITED STATES TAXATION

A. Petitioners' Income Is Fully Subject To Tax Under The Internal Revenue Code

The world-wide income of United States citizens is subject to taxation by the United States regardless of the citizen's residence or the source of such income. Internal Revenue Code of 1954, 26 U.S.C. 1; *Cook* v. *Tait*, 265 U.S. 47, 56 (1924). As has long been recognized, exemption from taxation is a matter of legislative grace and must be granted explicitly. *HCSC-Laundry* v. *United States*, 450 U.S. 1, 5 (1981); *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 429-430 (1955); *Helvering* v. *Northwest Steel Rolling Mills, Inc.*, 311 U.S. 46, 49 (1940); *United States Trust Co.* v. *Helvering*, 307 U.S. 57, 60 (1939). There is no merit to petitioners' claim that Article XV(2) of the Agreement in Implementation of Article III of the Panama Canal Treaty constitutes such an express exemption, permitting them to avoid all taxation on the salaries received from the Commission.[4]

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[4] Unless the petitioners' salaries are exempt under paragraph 2 of Article XV, the income earned by United States citizens from employment by the Commission would unquestionably be subject to tax. The basic exemption applicable for United States citizens employed abroad is set forth in 26 U.S.C. 911, 912. The exemption provided by Section 911 is specifically made inapplicable to amounts paid by the United States or an agency thereof. Since the Commission is an agency of the United States, income received by a United States citizen as compensation for his work for the Commis-

B. The Implementation Agreement Was Clearly Intended To Exempt United States Citizen Employees Of The Commission Only From Panamanian Taxes On Their Commission Salaries

1. *Controlling Principles Of Treaty Interpretation Require The Courts To Effectuate The Treaty Partners' Intent And To Give Great Deference To The Executive Branch In Determining That Intent*

Since the Implementation Agreement is an international executive agreement, its interpretation is subject to the same rules of construction applicable to treaties. *United States* v. *Pink*, 315 U.S. 203, 223-224, 227-230 (1942); *United States* v. *Belmont*, 301 U.S. 324, 330-332 (1937).

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sion would not be exempt from income tax under Section 911. *McCain* v. *Commissioner*, 81 T.C. 918, 921-924 (1983). The exemption provided in Section 912 for certain United States government allowances (*e.g.*, foreign areas allowances under certain statutes and cost-of-living allowances) is not applicable to the amounts involved in the instant case. See note 25, *infra*.

Nor do petitioners' salaries come within Section 931, which provides an exemption with respect to income derived from possessions of the United States. Although the term "possession of the United States" included the Canal Zone (Treas. Reg. 1.931-1(a)(1)), the salary or other compensation paid for services performed by a citizen of the United States as an employee of the United States government or of its agency was deemed for the purpose of Section 931 to be derived from sources within the United States (Section 931(h)) and thus did not fall within the exemption provided by Section 931. In any event, Section 931 is an historical relic as far as this case is concerned, for the Canal Zone ceased to be a possession of the United States as of October 1, 1979. (There is no claim in this case involving income earned prior to October 1, 1979.)

As this Court has indicated, the role of a court in interpreting international agreements is "limited to giving effect to the intent of the Treaty parties." *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 176, 185 (1982). See also *In re Ross*, 140 U.S. 453, 475 (1891). In determining that intent, courts appropriately examine not only the language used in the treaty, but also the context in which the language is used, the history of negotiations underlying the agreement, and the proceedings before the Senate. See *Air France* v. *Saks*, No. 83-1785 (Mar. 4, 1985), slip op. 3-4, 6-8; *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180, 184-185; *Factor* v. *Laubenheimer*, 290 U.S. 276, 294-295 (1933); *Nielsen* v. *Johnson*, 279 U.S. 47, 52 (1929). Because "few words possess the precision of mathematical symbols" (*Boyce Motor Lines, Inc.* v. *United States*, 342 U.S. 337, 340 (1952)), the judicial inquiry does not end with even seemingly unambiguous language where other factors, such as the conditions and circumstances existing at the time the provision was adopted, the question the provision was meant to resolve, and the practical construction adopted by the parties, indicate that an overly narrow reading of the language will not advance the treaty's aims. *Factor* v. *Laubenheimer*, 290 U.S. at 294-295; *In re Ross*, 140 U.S. at 475; *Great-West Life Assurance Co.* v. *United States*, 678 F.2d 180, 183 (Ct. Cl. 1982).[5] See also *FDIC* v. *Philadelphia Gear Corp.*, No. 84-

[5] In *Great-West Life Assurance Co.*, the language of the treaty contained no facial ambiguity and the parties stipulated that all of the literal requirements of the treaty provision granting an exemption were met. After examining the Senate Foreign Relations Committee report on the treaty and the accompanying documents from the State Department, the court held that the language of the treaty was not intended to grant the broad exemption claimed by the taxpayer.

1972 (May 27, 1986), slip op. 5-6. Thus, when confronted with two "plausible" readings of the language in a Treaty, this Court must "view the Treaty in the light of its entire language and history." *Kolovrat* v. *Oregon*, 366 U.S. 187, 192-193 (1961). See *TWA* v. *Franklin Mint Corp.*, 466 U.S. 243 (1984); *Washington* v. *Fishing Vessel Ass'n*, 443 U.S. 658, 675 (1979).

While the ultimate goal of adjudication is to give effect to the treaty partners' intentions, it has long been settled that the construction of an international agreement by the Executive Branch is entitled to great deference by the courts in determining that intent. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180-184; *Kolovrat* v. *Oregon*, 366 U.S. at 194; *Factor* v. *Laubenheimer*, 290 U.S. at 295. It is, after all, the Executive Branch that is charged with conducting foreign affairs. See *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304, 319-321 (1936); cf. *Haig* v. *Agee*, 453 U.S. 280, 293 (1981). For that reason, deference is the rule even when the treaty partner takes a view different from that taken by the United States.[6] *Factor* v. *Laubenheimer*, 290 U.S. at 298; *Charlton* v. *Kelley*, 229 U.S. 447, 473 (1913); *Whitney* v. *Robertson*, 124 U.S. 190, 194-195 (1888); *United States* v. *A.L. Burbank & Co.*, 525 F.2d 9, 15 (2d Cir. 1975), cert. denied, 426 U.S.

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[6] Contrary to petitioners' contention (O'Connor Br. 33), these controlling principles of treaty interpretation do not depend upon whether the government is a party to the case; they are applicable in all cases involving an international agreement, for the objective remains the same: to effectuate the purpose of the signatories. *Great-West Life Assurance Co.* v. *United States, supra; United States* v. *A.L. Burbank & Co., supra; United States* v. *County of Arlington*, 669 F.2d 925 (4th Cir.), cert. denied, 459 U.S. 801 (1982).

934 (1976). When, as here, "the parties to a treaty both agree as to the meaning of a treaty provision, and that interpretation follows from the clear treaty language, [the judiciary] must, absent extraordinarily strong contrary evidence, defer to that interpretation" (*Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 185).[7]

2. *The Language And Context Of The Implementation Agreement Demonstrate That No Exemption From United States Taxation Was Intended*

Any effort to ascertain the intent of the signatories to an agreement must begin with the language they employed. "The clear import of treaty language controls unless 'application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories.'" *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180, quoting *Maximov* v. *United States*, 373 U.S. 49, 54 (1963).

The language of Article XV shows that it was not intended in any way to restrict the right of the United States to tax its citizens working for the Commission. When read as a whole the article clearly reflects its purpose: to exempt the Commission and its United States citizen employees from taxation by

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[7] In searching for guides to the intent of the treaty partners, this Court has not confined itself to documents presented to lower courts, but has examined records and expressions of intent of both the United States and of a foreign government that were presented to it for the first time. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 184 n.9; *Factor* v. *Laubenheimer*, 290 U.S. at 295 (the Court's order for reargument invited counsel to conduct a further search through available diplomatic records and correspondence); *United States* v. *Reynes*, 50 U.S. (9 How.) 127, 147-148 (1850).

Panama on income or property other than private business activities in Panama unrelated to the Commission.[8] Although the term "Panamanian taxes" does not appear anywhere in the article, it is clear from the context that only such taxes are intended. Thus, paragraph 1 exempts the Commission, its contractors and subcontractors from payment "in the Republic of Panama of all taxes, fees or other charges on their activities or property." Paragraph 3 exempts United States citizen employees of the Commission and their dependents from payment of taxes, fees or other charges on "gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to * * * their own or their sponsor's work for the Commission."[9] The first sentence of paragraph 2, which

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[8] Petitioners contend (O'Connor Br. 34; Coplin Br. 5; Mattox Br. 7, 11), in effect, that analysis should begin and end with the phrase "any taxes," which they submit is unambiguous. But, as this Court has noted in other contexts, the word "any" is often an unclear guide to underlying intent. *E.g.*, *Ladner* v. *United States*, 358 U.S. 169, 170 n.1, 173 (1958) ("congressional meaning is plainly open to question on the face of the statute" (*i.e.*, "any person")); *Bell* v. *United States*, 349 U.S. 81, 83-84 (1955) (allowable unit of prosecution ambiguous under statute referring to "any woman or girl"); see *United States* v. *Kinsley*, 518 F.2d 665, 667-668 (8th Cir. 1975) (collecting cases).

More specifically, in cases involving treaty interpretation this Court has rejected efforts to wrench snippets of language out of context. The Court stated in *Petersen* v. *Iowa*, 245 U.S. 170, 173 (1917), that:

> if the mere letter of portions of the article when separately considered would leave room for any doubt on the subject, it would be dispelled by the context * * *.

[9] It is undisputed (Pet. App. 25a; O'Connor Br. 34) that paragraph 3 precludes only Panamanian taxation. Yet the language says the exemption is "from taxes," not merely

is at issue in this case, provides that "United States citizen employees and dependents shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission." If there is any doubt that, in context, this refers only to Panamanian tax, that doubt is resolved by the paragraph's following sentence, which exempts United States citizens employed by the Commission "from payment of taxes * * * on income derived from sources outside * * * Panama." To read paragraph 2 as granting an exemption from United States as well as Panamanian taxation would give credence to the argument that even interest earned by United States citizens from United States bank accounts and dividends paid to those citizens by United States corporations are exempt from United States income tax. Yet, similar income generated in Panama would be subject to both Panamanian and United States taxation (with a foreign tax credit being given by the United States under 26 U.S.C. 33 and 901 for the Panamanian taxes).

Such an irrational pattern of taxation was clearly never intended by the signatories. Accordingly, without even considering the Panamanian diplomatic note, a large majority of courts (and the majority of judges on the Federal Circuit panel) has concluded that Article XV focuses exclusively on Panamanian taxation.[10] As those courts have held, the article's

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Panamanian taxes. That Panamanian taxes alone are precluded is gathered from the context. Further, no one disputes that paragraph 1 implicates only Panamanian taxation.

[10] The Tax Court and many district courts have interpreted Article XV, paragraph 2, of the Implementing Agreement to exempt salaries of United States citizen employees of the Commission from Panamanian income tax, not from United States income tax. *Smith* v. *Commissioner*, 83 T.C. 702

purpose is to extend protection to United States citizens employed by the Commission (a United States government agency) from taxation by Panama—just as employees of United States government agencies pay no income tax to foreign host-countries around

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(1984); *McCain* v. *Commissioner, supra; Bergmann* v. *Commissioner*, 50 T.C.M. (CCH) 158 (1985); *Vamprine* v. *Commissioner*, 49 T.C.M. (CCH) 210 (1984), appeal pending, No. 85-4150 (5th Cir.); *Collins* v. *Commissioner*, 47 T.C.M. (CCH) 713 (1983); *Rego* v. *United States*, 591 F. Supp. 123 (W.D. Tenn. 1984); *Stabler* v. *United States*, 84-1 U.S. Tax Cas. (CCH) ¶ 9153 (N.D. Tex. Nov. 30, 1983); *Hollowell* v. *United States*, 84-1 U.S. Tax Cas. (CCH) ¶ 9142 (M.D. Fla. Nov. 21, 1983); *Watson* v. *United States*, 592 F. Supp. 701 (W.D. Wash. 1983); *Corliss* v. *United States*, 567 F. Supp. 162 (W.D. Ark. 1983); *Highley* v. *United States*, 574 F. Supp. 715 (M.D. Tenn. 1983); *Pierpont* v. *United States*, 83-2 U.S. Tax Cas. (CCH) ¶ 9647 (D.S.C. Oct. 3, 1983); *Snider* v. *United States*, 53 A.F.T.R.2d (P-H) 349 (W.D. Wash. Sept. 23, 1983); *Stokes* v. *United States*, 83-2 U.S. Tax Cas. (CCH) ¶ 9644 (W.D. Wash. Aug. 29, 1983); unreported opinions in *Skrable* v. *United States*, No. 84-3053 (W.D. Ark. May 13, 1985), appeal pending, No. 85-1743WA (8th Cir.), and in *Foster* v. *United States*, No. 84-952-CIV-T-13 (M.D. Fla. Apr. 1, 1985), appeal pending, No. 85-3446 (11th Cir.). See also *Billman* v. *Commissioner*, 83 T.C. 534, 541 n.6 (1984). To the contrary, see *Harris* v. *United States*, 585 F. Supp. 862, 863 (N.D. Ga. 1984), aff'd, 768 F.2d 1240 (11th Cir. 1985), petition for cert. pending, No. 85-1011. In *Swearingen* v. *United States*, 565 F. Supp. 1019 (D. Colo. 1983), the court held that an executive agreement (which the Implementation Agreement is) exempting United States citizens from taxation is not within the constitutional powers of the President. In addition, the Tax Court has recently held that in the virtually identical provision of Article XVI of the Agreement in Implementation of Article IV of the Panama Canal Treaty, Sept. 7, 1977, United States-Panama, T.I.A.S. No. 10032 (U.S. App. 2a-3a), United States citizen employees of the United States Armed Forces stationed in Panama are not exempt from United States taxation. *Rust* v. *Commissioner*, 85 T.C. 284 (1985).

the world. The purpose was not to relieve anyone of his duty to pay United States taxes.

Only by removing the words "any taxes" in the first sentence of paragraph 2 from their proper context can the petitioners argue that an exemption from United States taxes was created. To be sure, had the negotiators anticipated the question raised in this case they could have employed language that disposed of petitioners' contentions even more clearly. But the degree of precision even skilled draftsmen employ is generally a function of the draftsmen's perception of the precision needed to resolve the question at hand.[11]

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[11] Petitioners (O'Connor Br. 34-39) seek support for their interpretation, as did the Claims Court (Pet. App. 26a, 46a-47a), by looking at other provisions of the Treaty and at other agreements. While some portions of the Treaty refer expressly to Panamanian taxes, fees, etc., other provisions that clearly affect only Panamanian taxes are written in terms similar to paragraph 2 of Article XV. See Agreement in Implementation of Article III at Article XI(2)(h) (T.I.A.S. No. 10031) (contractors "shall be exempt from any taxes"); Article XIV(2)(b) (vehicles "shall not be assessed any license or registration fees"); Article XVI(2), (5)(a) and (c). In any event, that certain other provisions may have been written with more precision would, at most, support a tentative inference that the power of the United States to tax its citizens was implicated. But, as we have indicated (page 10, *supra*) such inferences cannot support an exemption from domestic taxation. See, *e.g.*, *HCSC-Laundry* v. *United States*, *supra*.

The model for the taxation sections of the Implementation Agreement was Article X of the Status of Forces Agreement with the Republic of China, Aug. 31, 1965, United States-Republic of China, 17 U.S.T. 373, T.I.A.S. No. 5986, terminated January 1, 1980 (C.A. App. 68, 70). Article X(2) (17 U.S.T. 381) of the Agreement with the Republic of China provides:

> Members of the United States armed forces, or the civilian component, and their dependents, shall be exempt from

See *Ex parte Peru*, 318 U.S. 578, 596-597 (1943) (Frankfurter, J., dissenting) ("Legislation by even the most competent hands, like other forms of com-

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> any direct tax imposed on income, except income derived from sources in the Agreement Area other than that resulting from services with or employment by the United States armed forces or by the corporations provided for in Article XII of this Agreement or by other United States governmental establishments in the Agreement Area.

That provision, like other Status of Forces Agreements (SOFAs) (C.A. App. 88), was designed to exempt from host-country income taxes, service-related salaries earned in the host country and non-host country source income. Accordingly, neither that Agreement nor any of the many other SOFAs employing similar or more precise terminology has ever been construed to provide an exemption from United States taxation.

More directly, the language of the provisions in question derives from paragraph 2 of Article XVI of the Agreement in Implementation of Article IV of the Panama Canal Treaty (C.A. App. 88-89), which was modeled after the foregoing provision. That paragraph provides:

> Members of the Forces or the civilian component, and dependents, shall be exempt from any taxes, fees or other charges on income received as a result of their work for the United States Forces or for any of the service facilities referred to in Article XI or XVIII of this Agreement. Similarly, as is provided by Panamanian law, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

The Tax Court in *Rust* v. *Commissioner*, *supra*, rejected the taxpayer's argument that this paragraph exempts from United States taxation the salaries of the members of the United States armed forces, the civilian component and dependents. Even the Claims Court opined (Pet. App. 45a-46a) that exemption from United States taxation was not provided by the first sentence of that provision, which is identical in all relevant respects to the provision at issue here.

position, is subject to the frailties of the imagination. Concentration on the basic aims * * * inevitably overlooks lacunae and ambiguities which the future reveals and which the future must correct."). And, as we now show, the language chosen in paragraph 2 was suitable to resolve the question under discussion —whether the wages of United States citizens employed by the Commission were to be subject to income taxation by Panama or any Panamanian authorities or agents.

3. *The Context In Which The Agreement Was Negotiated, The History Of The Negotiations And The Basis Upon Which The Senate Approved The Panama Canal Treaty, Confirm The Government's Interpretation That Exemption From Panamanian Taxes, Not United States Taxation, Was Intended*

The construction placed upon the Treaty by the United States, as well as by the Republic of Panama, is confirmed by the context in which Article XV was negotiated and by the negotiating history. Between February 26, 1904, and September 30, 1979, the United States exercised rights, power and authority over the Canal Zone that "it would possess and exercise if it were the sovereign" of the Zone "to the entire exclusion of the exercise of the Republic of Panama of any such sovereign rights, power or authority." Isthmian Canal Convention, Nov. 18, 1903, United States-Panama, art. III, 33 Stat. 2235, T.S. No. 431; 1977 Treaty, art. I(1)(a). See also, Treaty of Friendship and Cooperation with Panama, Mar. 2, 1936, United States-Panama, art. I, 53 Stat. 1807, T.S. No. 945. For several decades prior to entering into the 1977 Treaty, the United States operated the Panama Canal through its agent the Panama Canal Company

(Canal Company) and its predecessors. See Canal Zone Code, Pub. L. No. 87-845, § 61, 76A Stat. 8.[12]

The salaries paid United States citizen employees by the Canal Company were subject to United States taxation.[13] *McCain* v. *Commissioner*, 81 T.C. 918, 921-924 (1983); *Collins* v. *United States*, 299 F.2d 949 (Ct. Cl. 1962); Rev. Rul. 58-472, 1948-2 C.B. 30; 8 J. Mertens, *Law of Federal Income Taxation* § 45-61 (rev. ed. 1978). Moreover, pursuant to treaty, United States citizens residing in Panama and working for the Canal Company were not subject to Panamanian income taxes.[14] When the 1977

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[12] Title 2 was repealed by Section 3303(a)(1) of the Panama Canal Act of 1979, Pub. L. No. 96-70, 93 Stat. 499.

[13] Salaries paid to United States citizens working in a possession of the United States for the United States government or one of its agencies, like the Canal Company, were exempted from United States taxation between 1921 and 1951 if the employees otherwise satisfied the provisions of 26 U.S.C. (1940 ed.) 251(a) and its predecessors. Rev. Rul. 58-472, 1958-2 C.B. 30, 32. The provisions of Section 251(a) of the 1939 Code were first enacted in Section 262 of the Revenue Act of 1921, ch. 136, 42 Stat. 271, and were made effective as of January 1, 1921, by Section 263 of that Revenue Act (42 Stat. 271). Section 251 of the 1939 Code was amended by Section 220 of the Revenue Act of 1950, ch. 994, 64 Stat. 944, to preclude employees of the United States government or one of its agencies from obtaining the benefits of Section 251 of the 1939 Code. H.R. Rep. 2319, 81st Cong., 2d Sess. 58, 103 (1950); S. Rep. 2375, 81st Cong., 2d Sess. 48, 100 (1950). The relevant provisions of Section 251 of the 1939 Code and the exclusion of those benefits for employees of the United States government or of its agencies are found in Section 931 of the 1954 Code.

[14] Isthmian Canal Convention, art. X, 33 Stat. 2237; Treaty of Friendship and Cooperation with Panama, art. IV, 53 Stat. 1813; Treaty of Mutual Understanding and Cooperation with

Treaty became effective on October 1, 1979, the authority to exercise full rights of sovereignty in the area of the former Canal Zone was restored to the Republic of Panama (art. I(2) (T.I.A.S. No. 10030)), and the United States was granted the right to manage, operate and maintain the Panama Canal (art. III(1)).[15] The Commission became the agency through which the United States manages, operates and maintains the Panama Canal. Panama Canal Act of 1979, Pub. L. No. 96-70, § 1101, 93 Stat. 456 (22 U.S.C. 3611); 1977 Treaty, art. III(3), T.I.A.S. No. 10030. In changing the status of the United States' rights from plenary authority (as "if it were the sovereign" over a segment of Panamanian territory) to particular, functionally defined rights within a foreign nation, an obvious focus of concern was how Panama would thereafter treat the United States' agency and the agency's employees and their dependents who are United States citizens living and working under Panamanian jurisdiction. *Corliss* v. *United States*, 567 F. Supp. 162 (W.D. Ark. 1983); *McCain* v. *Commissioner*, 81 T.C. at 928. It is within that context that the parties agreed (1977 Treaty, art. III(9)) to provide for "the rights and legal status of United States Government agencies and employees operating in the Republic of Panama" in an implementing agreement. Thus, the stated raison d'etre of the Implementation Agreement, of which Article XV is a part, is to define rights of United States citizens with respect to Panama.

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the Republic of Panama, Jan. 25, 1955, United States-Panama, art. II, 6 U.S.T. 2273, T.I.A.S. No. 3297.

[15] The Treaty's Preamble acknowledges "the Republic of Panama's sovereignty over its territory."

It is fully consistent with this purpose that the negotiating history leading to the signing of the Panama Canal Treaty and its implementing agreements, and the ratification proceedings before the United States Senate, show that insofar as income taxes are concerned, the discussion focused solely on exempting from Panamanian taxation the salaries paid to the Commission's United States citizen employees. There was no discussion of exemption from United States taxation on Commission salaries or on other United States source income (C.A. App. 102, 105, 109, 112, 123-129, 152, 154, 162). As the record shows, the negotiations concerning Article XV, which was drafted by the United States (C.A. App. 17-18, 25-26, 192), took place during the so-called May 1977 round of negotiations that lasted at least into August 1977 (*id.* at 26, 63, 69, 113). The first internal United States draft (then numbered Article XVIII), dated June 26, 1977, provided in pertinent part as follows (C.A. App. 26, 71, 74):

> TAXATION
>
> 1. By virtue of this Agreement, the Canal Administration is exempt from payment in the Republic of Panama of all taxes, fees or other charges on its activities or property, including those imposed through contractors or subcontractors.
>
> 2. United States citizen civilian employees, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Canal Commission. Similarly, as is provided by Panamanian law, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

3. United States citizen employees, and dependents, shall be exempt from taxes, fees or other charges on gifts or inheritance or on personal property, the presence of which within the territory of the Republic of Panama is due solely to the stay therein of such persons on account of their or their sponsor's work with the Canal Administration.

At the June 30, 1977, negotiating session, the Panamanians pressed to tax the salaries of the Commission's United States citizen employees (C.A. App. 113, 116-117). The United States negotiators said that Panamanian taxation of those salaries would pose a great problem for the United States because "No employee of * * * the United States Government or of a government agency, is now subject to taxes in a foreign country; * * *" (*id.* at 115). The Panamanian negotiator suggested that perhaps the United States could concede primary taxing jurisdiction to Panama on such salaries through a tax credit mechanism (*i.e.*, the United States would tax the income, but give a credit for Panamanian taxes) (*id.* at 116-117). The United States said that no final answer could yet be given (*id.* at 115).

The second internal United States draft of Article XV (then Article XVIII) is dated July 10, 1977 (C.A. App. 75), and provides in pertinent part (*id.* at 77):

TAXATION

* * * * *

2. United States citizen civilian employees, and dependents, shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Panama Canal Administration. Similarly, they shall be exempt from payment of taxes, fees or other charges on income

derived from sources outside the Republic of Panama.[16]

* * * * *

At the July 11, 1977, negotiating session, the Panamanians continued to press the United States to allow Panama to tax the salaries of the Commission's United States citizen employees (C.A. App. 119-121). By then, the United States' position had hardened. Ambassador Linowitz stated (*id.* at 127):

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[16] Petitioners note that the second sentence of the first draft of Article XV(2) contained the phrase "as is provided by Panamanian law." Petitioners (O'Connor Br. 47; Coplin Br. 14-15) argue that the omission of that phrase indicates that a compromise was reached to exempt Commission salaries from United States taxation.

Petitioners read more into the removal of that phrase than the record will bear. The phrase merely reflected the fact that Panama, at the time that the agreements were negotiated, did not impose a tax on non-Panamanian source income. Removal of the phrase referring to Panamanian law assured the United States that if Panamanian law ever changed, Panama would still be under an international obligation to exempt from taxation the non-Panamanian source income earned by the United States citizen Commission employees.

In addition, as in paragraph 2 of Article XV, the term "any taxes" is used in paragraph 2 of Article XVI of the Agreement in Implementation of Article IV (relating to military matters). But again, in context, the taxes referred to are those of the host country in which the United States citizen is sent as an employee of the United States government or its agency, and not income taxes imposed upon United States citizens by the United States government. During the negotiations of the Panamanian taxation issue, the Panamanian negotiators recognized that the language of the SOFA was designed to exempt Defense Department personnel from Panamanian tax (C.A. App. 141). Adoption of similar language for Commission employees was intended to have the same effect and not a new effect—one never discussed—of exempting such employees from United States taxes.

> Now, on the income-tax question we do not have a paper. We have had very extensive discussions within our Government and analyses by the Treasury Department, the Internal Revenue Service, and other groups to determine whether there is a way of responding favorably to your suggestion without raising very formidable problems in other parts of the world. We have been advised that the problem is one that we cannot deal with as you have proposed. The taxation of the income received by U.S. employees from the United States Government, wherever earned, would run counter to the policy that the United States has adopted throughout the world; and this would be the first effort to have a breach in that kind of a relationship. And, therefore, we have no authority to accede to your request on this score.
>
> I can assure you we have tried in every way possible to explore the possibility; and, indeed, it is still being studied in some places in our Government. But I would be misleading you if I told you there is anything except a uniformly discouraging response that we have been receiving.

On July 12, 1977, the Panamanians again unsuccessfully urged the United States to agree that Panama could tax the salaries of the Commission's United States citizen employees (C.A. App. 134-141).

The next United States draft of Article XV (still Article XVIII) is dated July 13, 1977, and is identical to the July 10 draft (C.A. App. 78, 81). It was this draft that the United States first proposed to the Panamanian negotiators (*id.* at 26). On July 14, 1977, the Panamanians again tried without success

to persuade the United States to change its position on Panamanian taxation (C.A. App. 142-147).[17]

Whether the issue of taxation was again taken up is not clear (C.A. App. 148-149, 153-154, 157-158). But it is clear that nothing in the negotiating history suggests that anything other than the question of exemption from Panamanian taxation was ever considered. There is no mention in any document (either internal position papers or transcripts of the negotiations) that exemption from United States taxation was ever discussed.[18] The final version of Article XV, which deleted the word "civilian" in paragraph 2, was accepted without comment by the Panamanians

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[17] Petitioners' suggestion (O'Connor Br. 9-11) that there was a difference between the position taken by the United States "in-house" and in the negotiations with Panama is erroneous and arises from petitioners' selective reading of the record. In any event, had such differences existed they would have been irrelevant.

A memorandum to the Secretary of State dated July 19, 1977, "in preparation for discussion of economic aspects of the Panama Canal negotiations" (C.A. App. 150-152), indicates that the United States could address some of the Panamanians' economic concerns by acquiescing in Panamanian taxation of United States employees, but that such acquiescence would set an unfortunate international precedent. See also memorandum dated July 21, 1977, to the effect that the Panamanian position on taxes should be rejected (C.A. App. 161-162).

[18] The negotiating history of Article XV, as reflected in available documents at the State Department, was made a part of the record in the courts below and is available for this Court's consideration. Certain portions of the documents submitted to the Claims Court remain classified (see *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. at 320-321) and under seal by order of the Claims Court.

in August 1977 (C.A. App. 82-85, 192).[19] Thus, the government of Panama accepted the text drafted by the United States to reflect the United States' position.

Contrary to petitioners' contention (O'Connor Br. 47; Coplin Br. 14), there was no substantive change between the initial United States proposal and the final version of Article XV, paragraph 2, with respect to the exemption from taxation of the Commission salaries paid to United States citizen employees (see note 16, *supra*). The negotiations related solely to exemption of those salaries from Panamanian taxation, and exemption from United States taxation was never considered.[20]

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[19] Contrary to petitioners' allegation (Coplin Br. 14-15), the record clearly indicates that August was not the first time that Panama had seen the text of Article XV. See C.A. App. 26. The affidavit of Dr. Lopez Guevara merely states that the *final* text was proposed in August, 1977 (C.A. App. 192).

[20] Even the affidavit of Dr. Lopez Guevara, upon which petitioners rely, does not state that United States taxation was ever discussed (C.A. App. 192). His affidavit, as well as that of Michael G. Kozak (a member of the United States negotiating team) (*id.* at 27-28, 87-89), states that exemption only from Panamanian taxation was discussed. The Lopez Guevara affidavit provides only a personal interpretation of Article XV and states the affiant's belief that the Panamanian government would agree. He does not state, as petitioners indicate (O'Connor Br. 14), that Panama actually took the position that United States taxation was covered. His personal interpretation is of little value under the rules of treaty construction and his prophecy as to the view the Panamanian Government would take has not been borne out.

In addition to the affidavit of Dr. Lopez Guevara, the petitioners produced sworn statements from Messrs. Tack and Lakas (C.A. App. 182-191). Those statements have no probative value. Mr. Lakas' statement relies upon the response of

The Senate Committee on Foreign Relations held extensive hearings on the Panama Canal Treaty and its implementing agreements. Consistently with the history of the negotiations cited above, Herbert J. Hansell, Legal Adviser of the Department of State, testified (*Panama Canal Treaties: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. Pt. 1, at 214 (1977)) that "[w]ith regard to exemption from Panamanian taxes, the implementing agreements provide exemption from Panamanian taxes for U.S. agencies and their personnel, including dependents, and contractors." Senator Stone questioned Mr. Hansell on the point (*id.* at 268; U.S. App. 10a-12a (emphasis added)):

> Senator STONE. I think it was article XV, section 1 that raised an interesting question. I will read it to you. "By virtue of this agreement the Commission, its contractors and subcontractors are exempt from payment in the Republic of Panama of all taxes, fees, or other charges on their activities or properties." *Then, in No. 2, referring to U.S. citizen employees and depend-*

Mr. Tack. But Mr. Tack was not even involved in the negotiations of Article XV. Rather, Mr. Tack was involved in the treaty negotiations prior to 1977, before Article XV was negotiated.

The treatment of the Kozak affidavit by the Claims Court (Pet. App. 35a-36a n.16; Feb. 23, 1984 Tr. 31-32) and by the *Harris* court (768 F.2d at 1245) is wrong as a matter of law. Mr. Kozak, who is a deputy legal adviser of the Department of State, was one of the United States representatives responsible for drafting and negotiating the Panama Canal Treaty and its implementing agreements (C.A. App. 23, 27-29, 87-89, 156). The affidavit is clearly relevant to state the affiant's knowledge of what subjects were raised during the negotiations and the origins of the provision in question. *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 184 n.10.

ents, it says, "shall be exempt from any taxes, fees, or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payments of taxes, fees, or other charges on income derived from sources outside the Republic of Panama."

Of course, when that was announced, the press reported the glee of the Zonians that they were now exempt from U.S. income tax. When Senator Glenn asked you, are there any words that you would like to see in the treaty, I was just asking myself, would you like to see the words, United States, in there somewhere?

Mr. HANSELL. I am sorry to be a source of disappointment for the Panamanians [*sic*], but obviously *we are not entering into an agreement between the United States and Panama that would exempt U.S. citizens from U.S. tax. The purpose of this, of course, was to exempt them from Panamanian tax.*

* * * * *

Senator STONE. Wouldn't you think that we could put in the understanding that I suggested to you, the clarification of our interpretation which then, when ratified by the Congress, by the Senate, and deposited, would clarify that in a little more formal way than simple advices, since you don't want to put words back in the treaty through negotiation?

Mr. HANSELL. The one comment I would have with respect to that, and this relates to a couple of other points, is that we are dealing now with an internal U.S. matter, not a matter between the United States and Panama. That is, *we don't agree with Panama how we are going to tax our citizens. That is obviously an internal matter.* I would hope we could find ways of dealing with internal matters other than as understandings.

As the Tax Court commented in *McCain* v. *Commissioner*, 81 T.C. at 928 (footnote omitted)—

> This interchange confirms the position urged by * * * the Commissioner of Internal Revenue. In providing for the termination of more than 70 years of U.S. jurisdiction to exercise rights, power, and authority as "if it were the sovereign" and for the return of control over the Canal Zone to the Republic of Panama, the United States would be concerned how the Republic of Panama would treat U.S. citizen employees of the Panama Canal Commission, a U.S. agency. One area of particular concern would be the imposition by Panama of any taxes on the agency or its U.S. citizen employees. On the other hand, as pointed out by Mr. Hansell, the imposition of taxes by either sovereign on its own citizens would not have been of concern to the treaty negotiators. Clearly, the United States would have no interest in negotiating with the Republic of Panama on whether it may tax its own citizens.

See also *Corliss* v. *United States*, 567 F. Supp. at 164, 165.

The Senate report accompanying the Panama Canal Treaty confirms the point made by Mr. Hansell. In the section-by-section analysis of the Treaty and its implementing agreements, the report states (S. Exec. Rep. 95-12, 95th Cong., 2d Sess. 155 (1978)):

> Paragraph 2 exempts United States citizen employees and dependents from the imposition by Panama of taxes on income received as a result of their work with the Commission and on the income derived from sources outside Panama. Such persons are subject, however, to Panamanian taxation of any income derived from

> sources * * * [inside] [21] Panama, other than their employment with the United States Government.

The report (*id.* at 127) emphasized that the section-by-section analysis was [22]—

> prepared by members of the treaty negotiating team and * * * [has] been approved by the offices of the State and Defense Departments directly involved in the negotiations * * *. Accordingly, these comments may be considered as an authoritative source of information with respect to the negotiating background and interpretation of the Treaties.

One of the drafters of the section-by-section analysis (Mrs. Geraldeen G. Chester) drafted Article XV of the Implementing Agreement (C.A. App. 25-26, 46, 64).

The purpose of Mr. Hansell's testimony and the section-by-section analysis was to inform the Senate during its deliberations of what transpired in the negotiations and the interpretation placed upon the Treaty and the Agreements by the State Department. Forming, as they do, the contemporaneous construction placed upon the Treaty and Agreement by the bodies constitutionally charged with making and ratifying the treaty, they should be regarded as the prin-

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[21] As the court in *Corliss* pointed out (567 F. Supp. at 166 n.1), the report, in an obvious mistranscription, referred here to "income derived from sources outside Panama."

[22] The section-by-section analysis was prepared during the ratification proceedings in 1977 and sent to the Senate Foreign Relations Committee by letter dated December 23, 1977. *Panama Canal Treaties: Hearings Before the Senate Comm. on Foreign Relations*, 95th Cong., 1st Sess. Pt. 3, at 689, 709 (1977).

cipal guide to interpretation. See *Stabler* v. *United States*, 84-1 U.S. Tax Cas. (CCH) ¶ 9153 (N.D. Tex. Nov. 30, 1983).

Petitioners (O'Connor Br. 35 n.21; Coplin Br. 17, 33, 37-38; Mattox Br. 10-12) seek to turn Mr. Hansell's testimony on its head and transform his statement that a formal clarification was unnecessary into a concession that some domestic tax exemption springs from Article XV. A decision not to seek to enter into a formal understanding or clarification with the government of Panama after the negotiations had been concluded and the Treaty signed does not suggest that the negotiations involved exemption from United States taxation. Quite the contrary. The testimony before the Senate Foreign Relations Committee shows simply that the State Department believed that the subject of domestic taxation was not one on which clarification by Panama was warranted. The Senate obviously agreed with the State Department's view that the Treaty provided exemption from Panamanian taxation only (S. Exec. Rep. 95-12, *supra*, at 34) and did not request that the State Department seek clarification through a formal understanding with Panama. Had the Senate deemed clarification necessary, it could have requested further action, as it did with respect to other portions of the Panama Canal Treaty. See Reservations and Understandings; 124 Cong. Rec. 2693-2694, 10541 (1978). The Senate, however, concurred in the views expressed by the State Department. In these circumstances, Senator Stone's comment amounts, at most, to an inquiry by a single legislator concerning whether the meaning of Article XV(2) could usefully be clarified by a formal understanding. Nowhere, however, did Senator Stone, the Senate, or the Exec-

utive Branch ever contend that Article XV(2) in fact exempts United States citizens from United States taxation.

Petitioners (O'Connor Br. 35 n.21; Coplin Br. 33) further err in dismissing the section-by-section analysis as the product of two individuals who had not participated in the actual negotiations. The analysis was approved "by the offices of the State and Defense Departments directly involved in the negotiations" (S. Exec. Rep. 95-12, *supra*, at 127). Further, Article XV was drafted by one of the authors of the section-by-section analysis. The drafting of the provision in question and the section-by-section analysis was not done in vacuo. Like the testimony of Mr. Hansell, the section-by-section analysis was prepared by the State Department to inform the Senate about the negotiations, "not to aid the Internal Revenue Service in these cases." *Stabler* v. *United States*, 84-1 U.S. Tax Cas. at 83,185 n.4.

Nor is there any merit to petitioners' argument (O'Connor Br. 22-23, 42, 46-49; Coplin Br. 26) that Panama might have sought to have the United States exempt United States citizens from taxation as a compromise to break a diplomatic stalemate. First, petitioners' speculation is negated by the negotiating history which shows that there was no substantive change between the first internal United States draft of Article XV, prepared before the negotiations, and the final language. The negotiations related solely to the question of Panamanian taxation. At no time did Panama object to the imposition of United States taxes on any of the items or activities which, under paragraphs 1, 2, and 3 of Article XV, were exempt from Panamanian taxation. Rather, the negotiating history of Article XV shows that the Panamanian negotiators were not concerned with the manner in

which the United States taxed its citizens, but simply wanted to secure for their government a similar authority to tax.[23] Indeed, the Panamanian suggestion that both Panama and the United States (with a tax credit for Panamanian tax) might tax the salaries of the Commission's United States citizen employees clearly shows that Panama anticipated that United States taxes would be paid, and that Panama was willing to have such employees taxed at the higher United States rates so long as Panama got the first bite.[24]

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[23] The Claims Court emphasized that Panama's motivation in seeking to tax employees of a United States government agency arose from notions of sovereignty rather than economics. Whatever Panama's motivation might have been, it conceded the substantive point in the negotiations. There is no dispute that petitioner's Commission salaries are exempt from Panamanian taxation. The question here is whether an exemption from United States taxes was created, an issue which does not implicate either Panamanian sovereignty (which was secured in the Treaty's Preamble and Article I) or Panamanian revenue (also dealt with elsewhere in the Treaty).

[24] The Claims Court (Pet. App. 37a-42a) and the *Harris* court (768 F.2d at 1245 n.8) cited other provisions of the Implementation Agreement and the Panama Canal Treaty or other treaties in support of their conclusion that the Agreement barred United States taxation. Those other treaties have little bearing here because, as this Court noted in *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 185 n.12, other provisions "although similarly worded, may have different negotiating histories."

The *Harris* court cited the fact that the United States assumed certain obligations with respect to Commission employees in Article X of the Treaty. But the obligation imposed upon the United States under Article X of the Treaty runs to all employees of the Commission, the former Canal Company and the former Canal Zone Government, not just to those who

Petitioners suggest (O'Connor Br. 48-49) that there were sound policy reasons for granting a domestic tax exemption to the salaries paid to (and non-

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are United States citizens. Indeed, Article X shows that the Republic of Panama was eager to decrease the number of United States nationals working for the Commission. Article X(3) limits the employment of non-Panamanians to persons with skills not available in Panama, and provides for training of Panamanian employees, and Article X(5) requires the periodic rotation of non-Panamanians hired after the Treaty became effective. Moreover, Panama was eager for the United States to grant liberal entitlements to annuitants and thus to encourage United States citizens to retire so that Panamanian replacements could be hired. See S. Exec. Rep. 95-12, *supra* at 30, 135-136. In view of Panama's desire to reduce the number of United States nationals working for the Commission, Panama could scarcely have desired a provision exempting United States citizens from United States taxation, a benefit that surely would have discouraged voluntary departures by employees who were United States citizens.

The Eleventh Circuit's opinion in *Harris* also cites (768 F.2d at 1245 n.8) Articles XII (Entry and Departure), XIII (Services and Installations), XIV (Licenses), XVI (Import Duties), XVIII (Claims), and XIX (Criminal Jurisdiction) of the Implementation Agreement as examples of "special inducements" to encourage United States citizens to continue in the employ of the Commission. As we have shown, however, the express language of the Treaty reflects Panama's contrary desire: to reduce non-Panamanian employment. In any event, to the extent that the cited portions of the Implementation Agreement grant rights to United States citizen employees, they involve rights granted by *Panama*, not by the United States (see page 22, *supra*). For example, Article XII provides that United States citizen employees "shall be exempted from fiscal charges relating to their entry, stay in, or departure from" Panama. Article XIV(4)(c) provides that United States citizen employees who hold licenses issued by the United States, a state, or the former Canal Zone government, shall be issued equivalent Panamanian licenses "without being subjected to new tests or payments of new fees." Article

Panamanian source income earned by) United States citizen employees of the Panama Canal Commission, while permitting United States taxation of Pana-

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XVI(3) provides that certain goods, such as furniture, household goods and personal effects, shall be exempt from "the payment of import duties or other import taxes." (As is the case with the provision at issue here, these articles refer generally to "fiscal charges" and "import duties or other import taxes" without specifically identifying Panama as the taxing sovereign because only Panamanian authority was under consideration.) The other articles cited in *Harris* relate primarily to the rights of the Panama Canal Commission.

The Claims Court attempted to buttress its position by looking to income tax conventions between the United States and foreign governments. But it found no instance in which the United States discussed with a foreign country the domestic tax implications to United States citizens of their employment in that country by an agency of the United States. Nor is there any relevance in this case of treaties that provide tax credits against United States taxes for taxes paid to the treaty partner on foreign-source income. From the United States' point of view, those treaty provisions are largely redundant of the foreign tax credit provision, which has long been part of domestic statutory law. See 26 U.S.C. 33, 901-905.

More to the point, the foreign tax credit provisions do not constitute a surrender by the United States of tax jurisdiction over its citizens. Rather, they merely recognize that when United States citizens are subject to the taxing jurisdiction of the country in which the income is derived, the United States requires its citizens to pay a combined United States and foreign tax at least equal to the United States tax. That is a far cry from exemption from domestic taxation.

In the Swedish and German tax conventions cited by the Claims Court (Pet. App. 40a-41a), the United States agreed to refrain from taxing United States citizens who operate shipping and air transportation business in the other signatory states. But, those treaties contain savings clauses under which the United States may, regardless of any provision of those conventions, determine the tax of its citizens as if the conven-

manian-source non-Commission income. In fact, considerations of tax policy would dictate just the opposite conclusion. United States citizens employed by

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tions had not come into effect (Income Tax Convention with the Federal Republic of Germany, July 22, 1954, United States-Germany, art. XVI(1)(a), 5 U.S.T. 2768, T.I.A.S. No. 3133, and Income Tax Convention with Sweden, Mar. 23, 1939, United States-Sweden, art. XIV, 54 Stat. 1759, T.S. No. 958). Therefore, the provisions relied upon by the Claims Court provide no exemption from all taxes.

The Claims Court's comments about tax sparing, whereby the United States treats a United States corporation or citizen as having paid a foreign tax even though the foreign government relieves them of that tax, are particularly off the mark. While the United States has negotiated a few treaties with tax-sparing provisions (see, *e.g.*, the Income Tax Convention with Pakistan, July 1, 1957, United States-Pakistan, art. XV(1), 10 U.S.T. 984, T.I.A.S. No. 4232), none of those treaties has been ratified. See *Hearings Before the Senate Foreign Relations Comm. on Various Tax Treaties*, 97th Cong., 1st Sess. 10 (1981) (statement of John Chapoton, former Assistant Secretary of the Treasury for Tax Policy). In connection with the recent agreement with the People's Republic of China, the United States merely set forth its agreement (in an exchange of letters) to grant the People's Republic of China a tax-sparing provision if such a provision is ever granted to another country. Indeed, the refusal of the United States to conclude a tax-sparing agreement suggests that complete exemption from taxation is not favored. See, *e.g.*, C.A. App. 159-160; S. Exec. Rep. 5, 90th Cong., 2d Sess. 12-13 (1968); Schreyer, *Income Tax Treaty Between the United States and China*, 1984 Tax Mgmt. Int'l J. 259, 263; *United States Taxation and Developing Countries* 311-312 (R. Hellawell ed. 1980).

Finally, we note that in its consideration of the Tax Reform Act of 1985 (H.R. 3838, 99th Cong., 1st Sess. (1985)), the House Ways and Means Committee included a provision, Section 642, dealing with the effect of the Panama Canal Treaty and the Implementation Agreement upon United States taxation of citizens. The Committee Report (H.R. Rep. 99-426,

the United States government or its agencies, such as the Commission, are subject to United States taxation wherever they reside. Consistency in treatment therefore argues strongly against domestic tax exemption. Indeed, Congress had earlier expressed its disapproval of exemptions for military and civilian employees of the United States government and its agencies residing in certain possessions of the United States. See note 13, *supra;* H.R. Rep. 2319, 81st Cong., 2d Sess. 58, 103 (1950); and S. Rep. 2375, 81st Cong., 2d Sess. 48, 100 (1950). And, while the exemption from domestic taxation petitioners seek here has no sound policy basis, there is even less basis for the further exemption from taxation that is implicit in their argument. If this Court accepts petitioners' reading of the first sentence of Article XV(2), they would presumably make the same argument to secure an exemption under the second sentence (relating to their non-Panamanian source income). There could be no conceivable policy justification for exempting United States citizen employees of the Commission from taxation on interest, dividends or rent received from United States sources while taxing them on the same

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99th Cong., 1st Sess. 427-428 (1985)), after noting the conflict among the courts, points out that petitioners' reading of the treaty "is patently inconsistent with the intent of the drafters and with the views of Congress as reflected in well-established U.S. treaty policy" and that granting a complete exemption from all taxes "would have been completely inconsistent with the treaty policy of the United States not to alter by treaty the U.S. tax treatment of U.S. persons, particularly with respect to income from services performed for the U.S. Government or its agencies." As the House Committee pointed out, there is nothing to indicate that Congress intended to contravene its well-established taxation policies in entering into the Panama Canal Treaty and its implementing agreements.

type of income derived from Panamanian sources. See pages 38-39 note 24, *supra*. And, as we have pointed out (page 36 note 24, *supra*), such an exemption would have been contrary to Panamanian interests.[25]

In sum, the language of the Implementation Agreement, as construed in its proper context, the negotiating history and the ratification proceedings all clearly show that the treaty parties never contemplated an exemption from United States taxation.

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[25] There is no merit to petitioners' contention (O'Connor Br. 42 n.23) that a binational tax exemption can be found in the congressional formula allowing Commission workers to receive a supplemental allowance. As pointed out above (page 21 & notes 4, 13, 14), United States citizens who worked for the Canal Company, which was the United States agency operating the Canal prior to October 1, 1979, were subject to United States income taxation but were not subject to Panamanian income taxation. The Canal Company had discretion to provide to United States citizen employees additional allowances above basic compensation "for taxes which operate to reduce * * * the employee's disposable incomes in comparison with the disposable incomes of those employees who are not citizens of the United States" and could pay "an overseas (tropical) differential" (see Canal Zone Code, ch. 7, § 146, 76A Stat. 17). The authorization to pay additional amounts subject to domestic taxation is clearly not the equivalent of a tax exemption. Indeed, the present Commission likewise has discretion to provide additional allowances as "overseas recruitment or retention differential" (Panama Canal Act of 1979, Pub. L. No. 96-70 § 1217, 93 Stat. 465). These provisions merely maintain the status quo ante. *Smith* v. *Commissioner*, *supra*, 83 T.C. at 710-715. The legislative history of the post-treaty amendments to the formula for computing the allowance indicates that Congress did not believe that a binational tax exemption was created by Article XV(2). See H.R. Rep. 96-98, 96th Cong., 1st Sess. Pt. 1, at 33, 54-55 (1979).

4. *The Court Below Properly Accorded Weight To The Executive's Interpretation Of The Treaty And Properly Implemented The Interpretation Agreed To By The Treaty Partners*

As set forth at the outset, it has long been settled that the construction of an international agreement by the Executive Branch is entitled to great deference by the courts. See, *e.g.*, *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 180-184. The United States has not wavered in its interpretation of Article XV, and its interpretation is well grounded in the language and history of the provision.

One of the fundamental reasons for deferring to the Executive's interpretation of international agreements is that it is the branch of government "charged with * * * negotiation and enforcement" of such agreements (*Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. at 185) and cannot effectively discharge that constitutional function if its interpretations are lightly set aside. As this Court stated in *Haig* v. *Agee*, 453 U.S. at 292 (quoting *Harisiades* v. *Shaughnessy*, 342 U.S. 580, 589 (1952)): "matters relating to the conduct of foreign relations * * * are so exclusively entrusted to the political branches of government as to be largely immune from judicial inquiry or interference." See *Regan* v. *Wald*, No. 83-436 (June 28, 1984), slip op. 19. There is, accordingly, no merit to petitioners' suggestion that an inference should be drawn against the United States because it did not accede to the trial court's request that the Panamanian government be approached and its views solicited. It is, of course, an Executive function to determine when, under what circumstances, and on what subjects to approach foreign governments. In this case, the government chose not to raise with the Panamanian government, at the trial court's

behest, a wholly domestic issue that had not been the subject of negotiations. The Claims Court chose to draw "a negative inference" (Pet. App. 66a) and rejected the United States' longstanding, consistent interpretation. Instead, the court (although acknowledging that it had no indicia of Panama's official position) concluded that the agreement "should be construed as Panama would read it" (Pet. App. 68a). In effect, the court accorded greater deference to its speculation as to the meaning of the *silence* of the Panamanian government (which is not a party to these proceedings) than it did to the expressed views of the Executive Branch of the United States. Such an approach is contrary to the circumscribed judicial role in foreign affairs which this Court has endorsed; it also would lead to alarming implications for the conduct of the foreign relations of the United States.

In any event, by the time this case reached the court of appeals, the official Panamanian view was known. The Foreign Minister of the Government of Panama informed the United States in a note dated February 22, 1985, that the Government of the Republic of Panama concurred with the United States' interpretation that Article XV(2) of the Implementation Agreement provided an exemption from Panamanian taxes only. In accordance with the decisions of this Court (*e.g.*, *Sumitomo Shoji America, Inc.* v. *Avagliano*, 457 U.S. 183-184 (notes dated two months and five days before oral argument)), the court of appeals correctly considered this note.[26] Under well-

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[26] Contrary to petitioners' arguments (O'Connor Br. 31-32; Mattox Br. 13), there is no meaningful distinction between this case and *Sumitomo Shoji*. In *Sumitomo Shoji* the Japanese government informed the United States government of its interpretation in a note dated two months before oral argument in this Court and reinforced that view in a note

established rules, when both government parties to a bilateral international agreement concur in its interpretation, it is inappropriate for courts to chart a different course.

To do so would be to ignore the central fact that this case concerns the interpretation of a treaty, not just a dispute between private individuals. This court stated in *Choctaw Nation* v. *United States*, 119 U.S. 1, 28 (1886), that the rules governing public treaties "even in case of controversies between nations equally independent, are not to be read as rigidly as documents between private persons governed by a system of technical law, but in the light of that larger reason which constitutes the spirit of the law of nations." See *Air France* v. *Saks*, slip op. 3 (quoting *Choctaw Nation* v. *United States*, 318 U.S. 423, 431-432

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dated only five days before oral argument. The note in this case was dated ten days prior to argument in the court of appeals. Thus, there is no merit to the contention that the court of appeals should have ignored the Panamanian note, and even less merit to the notion that this Court should ignore a note submitted by a foreign government more than one year ago.

Nor is there merit to petitioners' claim that the court of appeals should have excluded the Panamanian note as a matter of judicial estoppel (O'Connor Br. 21, 24-26; Coplin Br. 40-42; Mattox Br. 17-18). That concept, which itself is not widely accepted (see *Konstantindis* v. *Chen*, 626 F.2d 933 (D.C. Cir. 1980)), precludes a party from taking different positions in separate causes of action based on the same facts. Of course, no two causes of action are here involved. The government has consistently urged that the Agreement does not bar United States taxation and has argued that the interpretation of the Executive Branch is to be accorded great weight, even if its treaty partner took a contrary position. That remains our position in this Court. As it happened, the treaty partner in this case has now explicitly concurred in the interpretation we urge. Certainly, this Court should not blind itself to this fact. See *Air France* v. *Saks*, slip op. 11.

(1943)) ("[T]reaties are construed more liberally than private agreements."). The ultimate aim of treaty interpretation is to effectuate the expectations of the treaty signatories, just as the ultimate inquiry in interpreting a statute is to effectuate the expectations of the legislative body. According to petitioners' position, the interpretation of an international agreement should vary from litigant to litigant, depending upon the record before the trial court. That argument falls of its own weight.[27]

Further, contrary to petitioners' contention (O'Connor Br. 29-31; Coplin Br. 27), the basis of a foreign government's interpretation is not open to challenge in a court of the United States. Once a foreign government presents a statement dealing with matters within its area of sovereign authority, American courts are obligated to accept that statement at face value as "conclusive." *United States* v. *Pink*, 315 U.S. at 220-221.[28] American courts long have recog-

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[27] Petitioners' argument would mean that in this case an international agreement should be interpreted to grant an exemption from United States taxation to six taxpayers because the Panamanian government expressed its views after the record in the trial court had closed, but that in all pending cases where the official Panamanian statement could be included in the record the same agreement would bar that exemption.

[28] Petitioners (O'Connor Br. 17 n.13, 42) misconstrue the purport of the Panamanian note. The purpose of that note is to present the Panamanian government's interpretation of the provision in question. Cross-examination is hardly called for. Although the note's import was the communication of the official government view and not the views of the individuals mentioned therein, it should be noted that among those consulted by the Foreign Minister of Panama was Dr. Escobar, who was the chief Panamanian negotiator during the period when the provision in question was negotiated (U.S. App. 8a; C.A. App. 113, 119, 134, 143, 144, 154; S. Exec. Rep. 95-12, *supra*, at 184).

nized that considerations of comity among sovereign nations—the idea that foreign nations are due deference when acting within their legitimate realm of authority—play a role in determining "the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation." *Hilton* v. *Guyot*, 159 U.S. 113, 164 (1895). See genearlly *McCulloch* v. *Sociedad Nacional*, 372 U.S. 10 (1963); *Lauritzen* v. *Larsen*, 345 U.S. 571 (1953); *The Charming Betsy*, 6 U.S. (2 Cranch) 64 (1804).

In accordance with well-established canons governing the interpretation of international agreements, the position of the United States is supported by the language of the agreement, the negotiating history, and the uniform interpretation of both signatory powers. As the court of appeals properly held, petitioners are not entitled to a tax exemption to which the treaty partners never agreed.

CONCLUSION

The judgments below should be affirmed.
Respectfully submitted.

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